

2004 - A year of progress

The SFC made significant achievements in four priority areas in 2004: keeping up market standards, facilitating market development, enforcing the law, and protecting and educating investors.

At a media briefing in January, SFC Chairman, Mr Andrew Sheng, and all other Executive Directors reviewed the SFC's accomplishments in 2004.

These included the successful implementation of Dual Filing, guidelines to address analyst conflicts of interest, consultation on a Takeovers Code review, further development of FinNet, more prosecutions of market manipulation and company investigations, launch of Dr Wise's Column, and revamp of the SFC website and eIRC.

The SFC was also actively engaged in the work of IOSCO (International Organization of Securities Commissions). We strengthened regulatory co-operation with our counterparts in



(From left) Mr Alan Linning, Mr Mark Dickens, Mr Andrew Sheng, Mrs Alexa Lam and Mr Peter Au-Yang listen attentively to a question from a reporter.

Indonesia, Thailand and the Philippines.

The SFC will continue to enforce the Securities and Futures Ordinance in 2005, with an emphasis on raising market quality.

During the quarter October to December 2004, the SFC recorded a surplus of \$45 million. Accumulated surplus for the first nine months of

the financial year was \$122 million. Total revenue for the first nine months rose to \$456 million owing to increased market turnover and activities. Total expenditure was \$334 million. At the end of December, the reserves stood at \$813 million. We expect to continue to have a surplus in the final quarter to 31 March 2005.

For details, please see press release issued on 14 February and 25 January 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR28?openDocument> and <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR13?openDocument>.

Review of Disclosure of Interests Regime

The SFC is consulting on a review of the Disclosure of Interests Regime under Part XV of the Securities and Futures Ordinance. The more significant proposals concern about how to make filings easier; disclosure of share pledges; the *de minimis* exception; and change in nature of interest.

We aim to minimise compliance burdens while preserving market transparency, and to keep the disclosure regime in line with market developments.

To make filings easier, we propose, among other things, additional codes to describe the events prompting a notification or the

capacity in which an interest is held. You are welcome to suggest other useful codes.

On share pledges by substantial shareholders, the SFC notes considerable market disagreement over the issue, and suggests, as a possible way forward,

(continued on page 6)

INSIDE

- Senior management interview: Ringo Chiu P.2
- Licensing of hedge fund managers
- Appointments
- Has your intermediary migrated to the new licensing regime? P.3
- Dual filing update
- Comments on listing regulation
- FAQs: Stock suspension
- IOSCO strengthens cross-border co-operation P.4
- Transition of UCITS III funds
- Investor focus: Keep your personal information safe P.5
- Understand what you pay for
- Investor Compensation Fund review P.6

Smart investors

In January, we presented the third batch of Smart Investor Awards to five members of the public who reported boiler rooms and Internet financial scams to the SFC. Their reports have resulted in the addition of seven dubious entities to the Alert List on the SFC-operated Electronic Investor Resources Centre (eIRC).

Since the Awards were introduced a year ago, 12 persons have won the awards. The Award is still open. You are welcome to report suspicious cases to the SFC.



(From left) SFC's Executive Director and Chief Operating Officer Mr Peter Au-Yang presents an SFC corporate watch and a certificate of recognition to Mr Xia De Liang and Mr Ip Wai Man, Eddie.

For details, please visit the eIRC at: http://www.eirc.hk/eirc/html/EN/alert/smart_investor_awards.htm. The Alert List is also available on the eIRC at <http://www.eirc.hk/eirc/html/EN/alert/alert.htm>.



Senior management interview

Mr Ringo Chiu, Chief Information Officer

What are your key responsibilities?

We provide IT support to the business operations of the SFC, in a secure and cost-effective manner. We use the latest technology to continuously enhance our operational efficiency and work with other market players to help strengthen Hong Kong's financial infrastructure.

How do you make the SFC more efficient?

Colleagues can securely connect to the SFC's systems with a computer whenever and wherever they like. We have also issued senior executives with portable wireless devices to read and write emails while on the go. We have tailor-made and upgraded many internal databases and work systems to enable colleagues to do their jobs efficiently.

Is information security a top priority?

Yes. The law requires the SFC and its staff to preserve secrecy. We have organised briefings and issued guidelines to raise staff awareness of information security. Staff can only log on to the network with both a



password and a security token. All sensitive emails are encrypted.

What is your role in improving Hong Kong's financial infrastructure?

We oversee the operations and development of FinNet, a business-to-business network for Hong Kong's financial communities. FinNet is reaching critical

mass with the introduction of Commercial Credit Reference Agency service (that provides information about the indebtedness and credit history of SME companies) and secure email service that are used by most of the banks. We expect new services and applications to be launched on FinNet continuously, so Hong Kong may become one of the first international financial centres to achieve straight-through processing on a single secure network.

Finally, have you caught any SFC staff using pirated softwares in the office?

Installation of any software must be performed by IT staff. Counterfeits are banned. Downloading of softwares and computer games from the Internet are strictly prohibited. We also regularly alert staff to the threat of computer viruses and keep our anti-virus programme and definitions up-to-date.

Personal bio

- Joined the SFC in April 2003 as the Chief Information Officer.
- Previously worked in the private sector including Citibank, Bankers Trust Company, AIG Investment Corp and ABN AMRO Bank.
- MSc in Information Management and Postgraduate Diploma in Business Analysis, University of Lancaster, UK.
- Qualified football coach. Currently coaching the SFC football team. Also regards himself as a serious movies lover.

Licensing of hedge fund managers

Since the establishment of a focus team in October 2004 to handle hedge fund managers' licence applications, we have received nine applications and approved three of them.

On average, the SFC took 10 weeks to process an application, including assessing a fund management company's corporate governance and control systems. The better the quality of an application is, the quicker it will be approved.

We endeavor to facilitate the entry of qualified market participants. But as a gate-keeper to guard against unsuitable persons, the SFC will never compromise on regulatory standards. An applicant must satisfy the SFC that it is a fit and proper person meeting all the competence and control requirements

to manage client funds.

The SFC reminds hedge fund managers that they can apply for a temporary licence while their asset management licence applications are being processed. With a temporary licence, hedge fund managers can meet with prospective clients and give investment advice, although they cannot perform any asset management functions. This helps them establish an early foothold in Hong Kong.

Hedge fund managers are welcome to email hedgefund@sfc.hk on questions about licensing matters.

For details, please see SFC press release issued on 2 February 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/!kUpNewsCode/05PR23?openDocument>

Appointments

- The Financial Secretary has appointed **Mr Eddy Fong**, **Mr Kenneth Kwok** and **Professor Liu Pak-wai** as Non-Executive Directors (NEDs) of the SFC from 1 January 2005 to 31 December 2007. They succeed Mr Thomas Brian Stevenson, Mr Daniel Fung and Ms Anna Wu, whose terms expired on 31 December 2004. The SFC welcomes the new NEDs and thanks Mr Stevenson, Mr Fung and Ms Wu for their outstanding contribution to the SFC and the Hong Kong market.
- The SFC has appointed **Mr Eddy Fong** as a member of the Takeovers and Mergers Panel and the Takeovers Appeal Committee from 1 January 2005 to 31 March 2005, the end of the current term. Mr Fong succeeds Mr Thomas Brian Stevenson.

Has your **intermediary** migrated to the new licensing regime?

Investors are advised to check the Public Register of Licensed Persons and Registered Institutions on the SFC website to see if their intermediaries have applied for migration to the new licensing regime under the Securities and Futures Ordinance.

If you find in your intermediary's record a remark of "Licensed/Registered under transitional arrangement (migration application not yet lodged)", you should immediately ask the firm as to its migration plan. You may have to make alternative arrangements with your assets or the

required services. It is because the existing licences of intermediaries, who were registered under the former licensing regime but do not submit their migration applications to the SFC during the two-year transitional period (which will end on 31 March 2005), will automatically lapse. Those firms will have to discontinue all regulated activities from 1 April 2005.

All licensees who were registered under the former regime but have yet to migrate should act now. This is to avoid last minute rushes or any interruptions to their businesses and

inconvenience to their clients. As long as they have lodged their applications before 31 March, they may continue to carry on the current regulated activities which they have applied for unless and until the SFC determines otherwise.

Licensees seeking to migrate should refer to the *Guidelines on Transitional Arrangements*, samples of completed migration application forms and related circulars.

For details, please see SFC press release issued on 21 January 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR9?openDocument>.

Dual filing update

Listing of part of a restructured corporate group is a feature of the Hong Kong market. In this respect, the SFC urges listing applicants to fully and clearly disclose their relationships with parent companies and fellow subsidiaries.

In the latest Dual Filing update, the SFC reported that it had received, via the Stock Exchange, 18 listing applications for the three months ended December 2004.

The SFC notes that listing applicants set up as a result of corporate restructuring usually rely heavily on substantial continuing connected transactions with their parent companies and/or fellow subsidiaries. This raises special disclosure concerns, such as in relation to the pricing power of the applicant and pricing policy for the continuing connected transactions; potential competition with and allocation of business opportunities within the parent group; and plans for reintegration, in particular the possibility of the parent injecting other assets into the applicant.

In certain instances, the only way to present a meaningful picture to potential investors is to include quantitative information about the parent group. Sponsors are also reminded to perform due diligence and seek to understand the operations of the whole business group in order to advise their clients on how to disclose all material information.

For details, please see press release issued on 6 January 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR2?openDocument>.

Comments on listing regulation

The Government and the SFC have released related proposals to enhance the regulation of listing in Hong Kong. The proposals aim to enhance corporate governance standards, upgrade market quality and strengthen investor confidence by giving major listing requirements the necessary enforcement teeth.

The Government's proposals seek to amend the Securities and Futures Ordinance (SFO), allowing the SFC to make rules to prescribe major listing requirements under the law. Breaches of these rules would become a new type of market misconduct, and subject to civil sanctions by the Market Misconduct Tribunal or criminal prosecution. The SFC would also be given power to impose civil sanctions on issuers, directors and officers for breaches.

The SFC has proposed to amend the Securities and Futures (Stock Market Listing) Rules, a piece of subsidiary legislation under the SFO, that would codify those listing requirements relating to the disclosure of price-sensitive information, financial reporting, and disclosure of and shareholders' approval for notifiable transactions and connected transactions.

The SFC's consultation closes on 31 March 2005 whereas the Government's consultation ends on 7 March 2005.

For details, please see SFC press release issued on 7 January 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR4?openDocument> and the Government's press release issued on the same day, available on the Financial Services and the Treasury Bureau's website at: http://www.fstb.gov.hk/fsb/ppr/press/doc/pr070105_e.doc.



Q: Why is trading of a stock suspended? How long will suspensions last?

A: The purpose of suspension is to ensure a fair, informed and orderly market, and to avoid any uneven information dissemination or opportunities for insider dealing. In general, a suspension will occur if there are material corporate activities (e.g. rights issues), fundamental concerns about a company's suitability for continued trading (e.g. involvement in material litigations), or unusual movements in price or trading volume, which may be caused by the leak of price sensitive information or market manipulation activities. Suspension can be initiated by the listed company itself or by the SFC/the Stock Exchange. There is no time limit for a suspension. Investors must closely monitor the announcements of the company concerned in newspapers and on the websites of HKEx or Growth Enterprise Market.

IOSCO strengthens cross-border co-operation

As global financial markets converge and cross-border financial fraud and securities market violations increase, enforcement co-operation between securities regulators worldwide has become increasingly crucial in combating activities that pose a threat to market integrity and investor protection. To close the gaps in the global network of co-operating regulatory authorities, the International Organization of Securities Commissions (IOSCO) has opened a confidential dialogue with jurisdictions whose ability or willingness to engage in enforcement co-operation with other regulatory authorities has been uncertain.

The objective is to ascertain whether there are any obstacles in these jurisdictions to implementing the IOSCO principles on

enforcement co-operation and information exchange and to encourage and assist them to join the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information.

Separately, IOSCO published in February its *Principles on Outsourcing of Financial Services for Market Intermediaries*, which provide a flexible and practical approach that will assist firms in determining the steps to take when considering outsourcing activities. There are seven Principles, covering the due diligence process in selecting a service provider; the contract with a service provider; business continuity issues; client confidentiality, concentration of outsourcing services; termination procedures and access

to books and records.

In December 2004, IOSCO also published the *Code of Conduct Fundamentals for Credit Rating Agencies* (CRAs). They represent a global, converged view of specific mechanisms CRAs can use to protect their analytical independence, eliminate or manage conflicts of interest, and appropriately handle confidential information shared with them by issuers. The *Code Fundamentals* aim to promote investor protection by safeguarding the integrity of the rating process.

For details, please see IOSCO press releases issued on 12 February 2005, 3 February 2005 and 23 December 2004, available on the IOSCO website at: <http://www.iosco.org/news/pdf/IOSCONEWS82.pdf>, <http://www.iosco.org/news/pdf/IOSCONEWS80.pdf> and <http://www.iosco.org/news/pdf/IOSCONEWS79.pdf>.

Transition of UCITS III funds

The SFC has started processing UCITS (Undertakings for Collective Investment in Transferable Securities) III fund applications.

UCITS III, an update of the UCITS I Directive, comprises two new European Directives and became effective in February 2002. UCITS III expands the investment powers of funds. Funds under UCITS III may use financial derivatives for investment purposes, not just for hedging or efficient portfolio management.

The SFC expects fund managers wishing to migrate their funds to UCITS III to make appropriate disclosures of all the changes in the investment scope, power and associated risks of UCITS III funds. They should also have adequate risk management and controls systems commensurate with the funds.

To facilitate the processing of UCITS III funds, the SFC has laid down guiding principles for the industry to work on the details to reflect the latest market development. The SFC also plans to review the *Code on Unit Trusts and Mutual Funds* and to consult the market as to how the relevant features of UCITS III could be accommodated in the *Code* on a longer-term basis. We will educate investors of the new investment flexibility offered by UCITS III.

We will work closely with the fund industry to ensure a smooth transition to the UCITS III regime. The public will continue to have access to a wide range of investment products in Hong Kong.

For details, please see press release issued on 1 February 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/1kUpNewsCode/05PR20?openDocument>.

In brief

The Public Shareholders Group held its 24th meeting in January. The SFC solicited feedback from members on a consultation paper on proposed amendments to the Securities and Futures (Stock Market Listing) Rules. (See *Comments on listing regulation* on page 3)



The latest SFC-RTHK drama series, *All about Stock Investing*, is now available in VCD. The Cantonese series features nine episodes of investment stories surrounding commuters on a public mini-bus. They cover topics like IPO subscription, finding the right inter-mediary, pooling risk of margin accounts and corporate governance. The public can get the free VCDs at the SFC office and also watch the series on the "Studio" section of the eIRC.



Circulars

The following recently published circulars are available on the SFC website under "Legislation & Regulatory Handbook" - "Regulatory Handbook" - "Codes, Guidelines and Circulars" at: <http://eapp01.sfc.hk/apps/cc/RegulatoryHandbook.nsf/eng/GenerateHTMLTB?openAgent>.

1. Circular to all Licensed Corporations - Securities and Futures (Financial Resources) Rules Enhanced Excel Format of Proforma Financial Return (28.01.2005)
2. Circular to Licensed Corporations and Associated Entities - Anti-Money Laundering / Combating Terrorist Financing (1) US President's Executive Order 13224 (2) United Nations (Anti-Terrorism Measures) Ordinance & United Nations Sanctions (Afghanistan) Regulation (30.12.2004)
3. Circular to all Licensed Corporations - Implementation of prudent risk management policies and procedures (29.12.2004)
4. Circular to deemed licensed corporations which have not submitted migration applications - Client assets arrangement in anticipation of business cessation (21.12.2004)



Investor focus

Keep your *personal information safe*

Investors should safeguard all personal data to avoid losses arising from identity theft. Below is a story based on a real-life case.

“Carson rang up Ruth, an old friend and a stockbroker of Care Brokerage Ltd, to enquire about opening a stock trading account. Carson told Ruth that he had not made up his mind yet. Ruth suggested that Carson pass a copy of his ID card to her first so that she could prepare the account opening documents for him to sign whenever he decided to go ahead. Carson did as requested.

Carson later decided not to open an account.

He asked Ruth to destroy the copy of his ID card, and the latter said she would.

Six months later, Carson was shocked to receive a call from Care Brokerage asking him to settle a \$2 million debt in an account in his name.

Carson found that Ruth had used the copy of his ID card to open an account with the brokerage, and passed her home address off as the address of the client. As a result, all letters and statements sent by the brokerage were mailed to Ruth. Carson knew nothing about the account or the trades in the account until he was pursued

by the brokerage for the debt.”

You should take extra care when entrusting your personal data to other persons, even people whom you know well. When opening an account, you should only provide a copy of your ID card during the account opening process. If your personal data are misused and an account is opened in your name, you may be held responsible for any debt.

If you find out that your personal data have been misused by an employee of a brokerage, contact the brokerage immediately and report the case to the SFC and the Police.

Understand **what you pay for**

To help investors understand the fees and charges of dealing and holding securities traded on the Stock Exchange, the SFC has introduced a leaflet, *Know What You Pay For*, and an on-line game, *Figure Your Fees*.

Know What You Pay For explains common fees and charges under six standardised categories that the SFC recommends that intermediaries adopt. There are illustrations to help investors calculate, interpret and compare the fees of different securities services providers. The leaflet is available free at the SFC office and the Consumer Advice Centres of the Consumer Council. It can also be downloaded from the eIRC under “Publications”.



Figure Your Fees, on the eIRC, provides players with a sample fee schedule (which shows the fees typically charged by an intermediary) and asks players to identify or calculate the applicable fees and charges for different transactions and investment portfolios. If you give a wrong answer, a window will pop up to explain the fees applicable to the transaction or the amount to be paid.

The game is available under “Game Zone”.

For details, please visit the eIRC’s “Publications” section at: http://www.eirc.hk/eirc/doc/EN/publications/e_leaflet.pdf and “Game Zone” at: <http://www.eirc.hk/eirc/html/EN/game/index.htm>.



Investor resources

The following items of investor resources have been made available to the investing public or updated recently. They can be found on the Electronic Investor Resources Centre (eIRC) at the URLs provided.

Investor Alert Updates (<http://www.eirc.hk/eirc/html/EN/alert/alert.htm>):

21 unlicensed companies have been added to the Alert List: “Warner Beck Incorporated” (16.02.2005); “Harrison Lee Partners”, “Regions Bank” (not related to Regions Bank, a subsidiary of Regions Financial Corporation, USA) (08.02.2005); “Capital Management Group”, “Yamato & Associates” (24.01.2005); “WeNew.net” (13.01.2005); “Union Bank of China”, “UBHK Securities Company Limited” (12.01.2005); “Smith Barney” (28.12.2004); “Hantec Group Asset Management Limited”, “Mission Finance Limited”, “World Trade Assets Market Inc”, “World Trade Assets Association”, “World Trade Assets Institute” (22.12.2004); “Global Options Group” (15.12.2004); “Goldmill Wagner Associates”, “International Options Trading Limited Pty”, “The Manhattan Pacific Group” (08.12.2004); “Lloyds and Barclays Inc.”, “Sterling Futures Management Limited”, “Washington Mutual Bank” (not related to Washington Mutual Bank, a subsidiary of Washington Mutual, Inc., USA) (01.12.2004). Information of four companies including “Vantage International Management Inc. .”, “Vantage International Management Group Inc. .” (19.01.2005); “Bernard Simpson Consultants” (08.12.2004); “SpartaMatrix” (04.02.2005) has been updated on the list.

Besides, we have added direct links to the investor alert lists of 12 overseas regulators (http://www.eirc.hk/eirc/html/EN/alert/boiler_room_overseas_regulators.htm) in the “Boiler Room Operation” subsection for investors’ easy reference. You can also access these links by clicking a pointer on our Alert List. (15.12.2004)

Dr Wise’s Column (<http://www.eirc.hk/eirc/html/EN/features/index.htm>)

“Behind the Scenes of an IPO” (25.01.2005), and *Understand What You Are Paying For*” (28.12.2004).

Investor Compensation Fund review

The SFC has proposed to suspend the existing investor compensation levies to reduce burden on investors.

The Investor Compensation Fund (ICF) compensates investors whose intermediaries default. Each investor is entitled to compensation of up to \$150,000 for trading securities or futures contracts on the exchanges.

The ICF is funded by investor compensation levies of 0.002% on securities transactions (i.e. \$2 for a \$100,000 transaction) and \$0.5 (\$0.1 for smaller size contracts) per contract on futures transactions.

In a recent consultation paper, the SFC has proposed to suspend

the investor compensation levies as soon as practicable when the net asset value of the ICF reaches \$1.4 billion, which is the self-funding level based on the estimated annual expenditure of ICF (including compensation payments) and rate of return for the ICF. The proposal aims to reduce the burden on investors and not to accumulate amounts beyond what was necessary for the ICF.

The consultation period has just ended. We are analysing the submissions and will issue a consultation conclusions paper.

For details, please see press release issued on 22 December 2004, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/04PR253?openDocument>.

Other publications

The following publications have been published since the release of the last *SFC Alert*. They are available on the SFC website under "Speeches & Publications" - "Publications" at: <http://www.sfc.hk/sfc/html/EN/speeches/public/public.html>.

1. SFC Enforcement Reporter - February 2005 (15.02.2005)
2. SFC Quarterly Report - October to December 2004 (14.02.2005)
3. SFC Enforcement Reporter - January 2005 (24.01.2005)
4. Consultation Paper on the Review of the Disclosure of Interests Regime under Part XV of the SFO (20.01.2005)
5. Consultation Paper on Proposed Amendments to the Securities and Futures (Stock Market Listing) Rules (07.01.2005)
6. SFC Enforcement Reporter - December 2004 (22.12.2004)
7. Consultation Paper on the Review of the Level and Funding of the Investor Compensation Fund, Broker Defaults since 1998 and the Operation of the Investor Compensation Arrangements (22.12.2004)

Disclosure of Interests

(continued from page 1)

requiring substantial shareholders and lenders to report immediately when a lender takes steps to enforce a security interest.

We also seek views on two options to address the difficulty with the current operation of the *de minimis* exception, i.e. simplifying the exception, or changing the disclosure regime altogether so that the *de minimis* exception is not necessary.

We also propose to define the circumstances which constitute a "change in nature of interest" with an exhaustive list so that it is easier to determine when such a disclosure obligation arises.

The consultation closes on 28 February 2005.

For details, please see SFC press release issued on 20 January 2005, available on the SFC website at: <http://eapp01.sfc.hk/apps/cc/PressRelease.nsf/eng/lkupNewsCode/05PR8?openDocument>.

Recruitment

The following SFC positions are open. For application and details of the openings, please visit the SFC website at: <http://www.sfc.hk/sfc/html/EN/aboutsfc/employment/employment.html>.

- **Senior Manager/Manager - Corporate Finance**
- **Manager - Enforcement (Disciplinary Function)**
- **Manager - Investment Products**
- **Clerk - Corporate Finance**
- **Temporary Clerk**

Subscription information

The bi-monthly *SFC Alert* forms part of our range of regular publications; others include the monthly *SFC Enforcement Reporter*, the *Quarterly Report*, the *Quarterly Bulletin* and the *Annual Report*. All these publications are posted on the SFC website.

Free subscription to the electronic version of the *SFC Alert* (and other publications) can be made to sfcalert@sfc.hk.

Feedback

Tell us what you think of the *SFC Alert*. Questions and comments can be sent to sfcalert@sfc.hk.

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